STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Central Illinois Public Service Company (AmerenCIPS) and Union Electric Company (AmerenUE)	:	**02-0798**
Application for entry of protective order to protect confidentiality of materials submitted in support of revised gas service tariffs.	:	
Central Illinois Public Service Company	:	**03-0008**
Proposed general increase in natural gas rates.	:	
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REPLY BRIEF OF THE STAFF OF
THE ILLINOIS COMMERCE COMMISSION

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REPLY BRIEF OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

Pursuant to 83 Ill. Adm. Code 200.800, Staff of the Illinois Commerce Commission ("Staff"), by and through its attorneys, hereby files its Reply Brief in the above-captioned proceeding. On July 28, 2003, Initial Briefs ("IB") were filed in this matter by Staff, AmerenCIPS ("CIPS") and AmerenUE ("UE") (collectively the "Companies" or "Ameren"), Office of the Attorney General on behalf of the People of the State of Illinois ("AG"), Citizens Utility Board ("CUB"), Business Energy Alliance and Resources, L.L.C. ("BEAR"), and MidAmerican Energy Company ("MEC"). Staff hereby submits this Reply Brief in reply to several claims made by the parties in their Initial Briefs.[1]

I. BACKGROUND; PROCEDURAL HISTORY; NATURE OF OPERATIONS; TEST YEAR

A. Background

B. Procedural History

C. Nature of Operations

D. Test Year

II. RATE BASE

A. Introduction

B. Uncontested Issues

1. Gas Plant Held for Future Use

2. Depreciation Policy

3. Original Cost Determination

4. Richwood Storage Field

C. Contested Issues

1. Post-test Year Capital Additions

To support the Companies' position regarding the pro forma adjustment to post-test year capital additions, the Companies offered cites for two Commission Orders. The Companies' first cite is Kankakee Water Co., Docket No. 85-0056, pp. 7-8. (Ameren IB, p. 7.) The docket and pages cited set forth the Minimum Monthly Bills at the present and proposed rates. Staff fails to see how these two pages have even a

[1] For clarity, the format of Staff's Reply Brief mirrors the outline that was used in Staff's Initial Brief; however, only issues raised by parties' Initial Briefs that warrant discussion are discussed in this Reply Brief.

remote connection to post-test year additions. Furthermore, these two pages make no reference to the Public Utilities Act ("Act") or any statute and do nothing to support the Companies' previously stated position on post-test year additions. The second citation noted by Ameren, Commonwealth Edison Co., Order on Remand, Docket No. 99-0117 (January 15, 2002) (Id.), gives no specific page reference. This docket is an electric company delivery services tariff ("DST") case and most references are to the filing requirements for DSTs and are not relevant to this rate proceeding. The Companies have not explained how these cites support their position.

In contrast to Ameren's Initial Brief, the AG's Initial Brief presents valid references to evidence presented in written testimony, hearing transcripts and reiteration of its position with clear illustrations. (AG IB, pp. 3-7.) AG witness Effron illustrates that these pro forma additions should not be allowed because the actual post-test year balance of net plant in service is less than the test year net plant in service balance, exclusive of pro forma additions proposed by the Companies.

Although Ameren and AG use the same citation, 83 Ill. Adm. Code 285.150(e), each provides a different understanding of the section. Ameren appears to understand the phrase "may propose pro forma adjustments" to mean that the Commission must accept the proposed adjustments as fact, whether or not substantiated, and include them in the revenue requirement. (Ameren IB, p. 6.)

Conversely, the AG hones in on the portion of the section that states "shall reflect significant changes" and indicates an understanding of the need for substantiation and portrayal of the Companies' condition of being as close to actuality as possible. The AG then proceeds to explain in detail why the pro forma additions proposed by the

Companies do not bring the Companies' condition as close to actuality as its own proposal. (AG IB, pp. 3-7.)

AmerenCIPS and AmerenUE have repeatedly stated that 83 Ill. Adm. Code 285 ("Part 285") allows them to choose a historical or future test year and the Companies chose to use a historical 12-month period as the test year for this proceeding. According to the Companies, Part 285 further specifies that a historical test year may be adjusted for known and measurable changes occurring within 12 months. (Ameren IB, p. 6.) While Part 285 allows a utility to propose pro forma adjustments for known and measurable changes to the historic test year, in certain circumstances, Part 285 requires the proposed adjustments to be individually identified and supported in the Direct Testimony of the utility. In the instant proceeding, the record shows that Staff did consider the pro forma post-test year additions to plant in service. However, Ameren provided no evidence to explain why such pro forma additions should be reflected in rates given that the balance of net plant in service is actually declining. In other words, AmerenCIPS and AmerenUE have not supported the assertion that the pro forma adjustments for post-test year plant additions are necessary to reflect the actual net plant in service balance at the time the new rates will go into effect. As AG witness Effron demonstrates, the net plant in service balance has been steadily declining or staying relatively even (no major increase or decrease) during the period 1997 through 2001. (AG IB, p. 4.)

While Part 285 allows the Companies to propose such pro forma adjustments, and the Commission must consider such adjustments where they are known and measurable, Part 285 does not guarantee that the Companies will be allowed to reflect such adjustments in base rates. The Companies must still justify the inclusion of the pro forma adjustments in rates. Accordingly, it would not make sense to increase rate base for post-test year pro forma plant additions at a time when the Companies have shown a declining rate base trend, based on their own evidence.

Therefore, Staff concurs with the conclusion reached by the AG in its Initial Brief regarding AG witness Effron's proposed adjustment for the removal of post-test year pro forma plant additions, as more fully demonstrated in AG Exhibit 1.0P, pp. 4-6.

2. Cash Working Capital Allowance

Staff continues to recommend that the cash working capital ("CWC") requirement be set at zero for CIPS and UE in these proceedings. The Companies' analyses include inappropriate data and unsupported assumptions; therefore, the Companies have failed to meet the burden of proof.

a. Disallowance of a separate PGA revenue lag

Staff's arguments for the disallowance of a separate PGA revenue lag are set forth in its Initial Brief on pages 8-10, the most significant of which is the fact that the PGA mechanism is a matching between revenues and expenses. Cash flows are not considered in the PGA mechanism. Cash flows are the focus of a lead/lag study.

The Companies cloud the issue by discussing the over/under-recovery mechanism in the PGA clause and insinuate that some "more complicated math" is involved. The Companies' confusion becomes apparent with the statement that "the Companies use the PGA to normalize gas costs." (Ameren IB, pp. 16-17.) The purpose of the PGA mechanism is to calculate the PGA rate charged each month to the ratepayers for the actual gas they consume. The Companies use the PGA mechanism clause as a form of rate stabilization (Id., p. 17); the PGA mechanism has no impact on gas costs to the Companies.

The confusion is further demonstrated by the Companies' statement regarding the "differences in nature of the billing and payment processes between the PGA and base rates". (Id., p. 12.) Ameren witness Subbakrishna acknowledged that the single bill a customer receives and pays each month includes charges both at the PGA rate and the base rate. (Tr., p. 377-378.) There is no difference in billing or collection of payments between PGA and base rates. The difference between PGA and base rates is the method of calculation of the PGA rates and the method of calculation of base rates that are utilized for billing purposes.

b. Disallowance of PGA fuel costs

Staff lists the concerns related to PGA fuel costs not addressed by the Companies on page 11 of its Initial Brief. These concerns were based on the sample of invoices Staff reviewed pertaining to CIPS' lead/lag study for PGA fuel costs. Ameren states that one of its criteria in selecting its samples of fuel invoices was that the samples contain "sufficient data points to be representative of the population." (Ameren IB, p. 19.) Each of the five concerns listed in Staff's Initial Brief on page 11 addresses items that are outside the "population" of fuel invoices for CIPS, the analysis from which Staff's sample of invoices was chosen. Therefore, the sample is not representative of the "population" which was being analyzed.

c. Disallowance of fuel expense and other operations and maintenance expense

Ameren states that Staff's criticism of its application of the obligation date theory is groundless. (Id., p. 20.) The Companies also claim that it was too difficult to ascertain delivery dates for gas or other operations and maintenance expenses. (Id., p. 10.) In the sample of invoices reviewed by Staff, the delivery dates were clearly indicated. Ameren claims that the invoices were "extremely voluminous" (Id.); however, Ameren chose the sample on which to base its analysis; the volume was of its own choosing. While the Companies assumed that deliveries were made evenly throughout the month (Id.), they did not offer any support for the accuracy of that assumption. Their own definition of an expense lead is the measurement from receipt of goods or services to payment for those goods or services. (AmerenCIPS Exhibit No. 6.0, p. 4.) Without consideration given to the timing of the actual receipt of the goods and services, their analysis is severely flawed and should be given little, if any, weight in the determination of the CWC requirement.

d. Mid-point theory

While Ameren contends that it has made several adjustments to its lead/lag study in response to Staff's concerns with its application of the Mid-point theory (Ameren IB, p. 18), Staff was unable to verify that those adjustments in fact adequately addressed those concerns. Staff's concerns were pointed out in Direct Testimony filed on April 2, 2003. Staff did not receive Ameren's workpapers related to the changes it eventually made until June 27, 2003 – just five business days before the start of the hearings. Introduction of new information at such a late date significantly hampered Staff's opportunity for a thorough review.

e. Service Company involvement

Ameren argues that the relative difference in size between CIPS and UE explains why the lead-time for other operations and maintenance ("O&M") expenses should be different. However, most of the items that would fall into the other O&M expense category would be those types of items such as office supplies that would be centrally purchased for all the operating companies under the Ameren umbrella and then allocated to the operating companies. Thus, no different lead-time would exist from one operating company to another. Ameren also states that there is a more complex procedure between Accounts Payable and those personnel responsible for authorizing payments of invoices. (Id., p. 21.) While this may have some impact on internal operations, it does not impact the payment terms for a given vendor or the time actual payments are made for goods or services purchased.

Ameren once again mischaracterizes Staff's position in stating that Staff expects different lead times for CIPS and UE fuel costs, yet identical lead times for other O&M expenses. (Id., p. 22.) Staff only expects lead/lag studies consistent with the definitions under which the Companies claim to have conducted them.

f. Conclusion

In Ameren's opinion, Staff has not identified any items which materially impact the results of its lead/lag studies. (Id., p. 15.) Ameren is simply wrong. Staff has pointed out flaws and concerns with the data used by the Companies as well as questioned the assumptions on which the Companies based the lead/lag analyses. Instead of addressing these issues head-on, Ameren chose those to which they could easily reply while ignoring other legitimate issues. The burden of proof is on the utility in a rate case filing. Ameren has clearly failed to meet its burden of proof in this proceeding. Based upon Staff's testimony and arguments presented in its Initial Brief, the Commission should accept Staff's adjustments reducing the level of CWC to zero for both CIPS and UE.

3. Materials and Supplies

Staff again notes Ameren’s failure to distinguish between the various components of working capital included in this proceeding: cash working capital (discussed above), materials and supplies inventory, and gas in underground storage. Ameren confuses the accounts payable related to materials and supplies inventory, one component of working capital, with cash working capital, a separate component of working capital. Staff has argued throughout this proceeding that this proposed adjustment does not result in the recognition of a single element of cash working capital. This is true because the materials and supplies inventory represents a separate component of working capital, distinct from cash working capital. (Tr., p. 391.)

The purpose of Staff's adjustment is to limit the return on the investment in materials and supplies inventory, a component of working capital, to the actual amount invested by the shareholders. (Staff IB, pp. 17-18.) At any given point in time, some items of materials and supplies inventory are not paid for (accounts payable). These items are financed by the respective accounts payable vendors, not the shareholders of the Companies. It is appropriate, therefore, to limit the amount of materials and supplies inventory included in rate base to the portion that is financed by Ameren’s shareholders. Staff's proposed adjustment would accomplish this.

Accordingly, Staff recommends the Commission approve Staff's proposed adjustment to limit the amount of materials and supplies inventory, a component of rate base, to the net amount invested by the shareholders, in accordance with the treatment approved by the Commission in the more recent cases listed in Staff's Direct Testimony. (ICC Staff Exhibit 3.0, p. 12.)

4. Working Gas in Storage

Staff disagrees with the cursory discussion that AmerenCIPS provided regarding Staff's recommendation to reduced its working capital allowance for gas in storage by $842,000. (Ameren IB, pp. 24-26.) CIPS' only argument is that Staff's reliance on historical information is fundamentally flawed because historical storage inventory levels are not representative of how CIPS uses storage and of the inventory levels that CIPS will likely experience in the future. (Id., p. 26.) Staff disagrees.

AmerenCIPS alleges that because it has substantially increased its contracts for leased storage capacity, made physical improvements to its on-system storage fields, and increased its reliance on storage as a hedging tool, the historical information of its test year inventory levels are more representative of the inventory levels CIPS will experience in the future. (Id., p. 25.) However, the record clearly indicates CIPS' claims are unfounded. In particular, Staff accepted, in total, the significant increase that CIPS made to the volumes it reserved for two of its leased storage facilities – Panhandle and Trunkline. (ICC Staff Exhibit 17.0 Revised, p. 16.) The record also clearly indicates that the capacity amounts that CIPS reserved for its other two leased storage agreements did not change. (Staff IB, p. 21; ICC Staff Exhibit 17.0 Revised, Schedule 17.5 CIPS.)

Further, as discussed, in detail, on pages 21 through 24 of its Initial Brief, Staff accounted for every change, including any on-system improvements, that AmerenCIPS made to its other storage facilities and fully explained why it selected the volume of gas calculated for each storage facility. (Staff IB, pp. 21-24.) Staff also previously explained why CIPS' argument for increasing its reliance on storage for hedging purposes is disingenuous. (Id., pp. 20-21.)

In addition to the above discussions, the evidentiary record disputes AmerenCIPS' assertion that its test year gas in storage inventory is a representative value. In particular, CIPS noted that the increased inventory at the Sciota storage field was attributable to reduced withdrawals as a result of unusually warm weather in 2001. (AmerenCIPS/UE Exhibit No. 11R, p. 11; Staff IB, p. 18.) Not only does this refute CIPS' arguments, but this warm weather would have also impacted every other leased and owned storage field in 2001. (ICC Staff Exhibit 17.0 Revised, p. 17; Staff IB, p. 18.) Further, AmerenCIPS did not dispute Staff's assertions that the test year gas volumes in storage were higher than normal. (ICC Staff Exhibit 17.0 Revised, p. 18.) Therefore, CIPS itself provides the reason why its test year levels were higher than other historical levels -- the warm weather from 2001.

The record clearly indicates that Staff's calculation regarding the appropriate volume of natural gas to allow AmerenCIPS in this proceeding is justified and reasonable. Staff's calculation accounted for all revisions that CIPS made to its storage facilities as well as accounted for the higher than normal levels of natural gas that CIPS maintained in storage during the test year. Therefore, the Commission should accept Staff's recommendation and reduce AmerenCIPS' working capital allowance for gas in storage by $842,000.

5. Accumulated Deferred Income Taxes

6. Retirement of Belle Gent Storage Field

Staff disagrees with AmerenCIPS' reasons for rejecting Staff's recommendation to retire the Belle Gent storage field. CIPS provided a very basic discussion of why it believes the Commission should not order it to retire Belle Gent storage field. (Ameren IB, pp. 28-30.) Particularly, CIPS claims three reasons why the Commission should not order it to retire the Belle Gent storage field – it is used to serve customers, it provides a backup to the Johnston City storage field, and it has potential value should CIPS conduct future expansion of the Belle Gent storage field. (Id., pp. 29-30.)

Staff fully explained in its Initial Brief why each of AmerenCIPS' three reasons is invalid. (Staff IB, pp. 26-30.) The specific details for each need not be discussed again, however, it is worthwhile to repeat that CIPS admitted that since November 1, 1993, it has only operated the Belle Gent storage field 12 days, with half of those days being non-winter season occasions. Further, on each of those 12 days, CIPS' gas supply portfolio would have provided reliable service had Belle Gent not been available. (ICC Staff Exhibit 4.0, p. 23; Staff IB, pp. 26-27.) Stated differently, AmerenCIPS could have provided reliable gas service to its customers over the last ten years without the Belle Gent storage field operating at all.

For the reasons discussed above, as well as Staff's discussion from its Initial Brief, the record clearly indicates that AmerenCIPS has failed to show that the Belle Gent storage field is needed to provide service to customers or that the field provides any economic benefits to customers. Therefore, Staff considered the facility to no longer be used and useful in providing service to AmerenCIPS' ratepayers and recommends the Commission direct CIPS to retire the facility.

AmerenCIPS also noted that it considered the retirement of a storage facility beyond the scope of what the Commission should consider in a rate proceeding. (Ameren IB, p. 29.) Staff disagrees with CIPS' assessment that the Commission's authority is limited in this regard. Nevertheless, Staff would agree that should the Commission accept Staff's recommendation to retire the Belle Gent storage field, it would be consistent policy for the Commission to use the same arrangement that AmerenCIPS and Staff reached for the Richwood storage field whereby the storage facility is removed for ratemaking purposes but it is not necessarily physically retired. (Staff IB, pp. 6-7.)

D. Recommended Rate Base

III. OPERATING REVENUES AND EXPENSES

A. Introduction

B. Uncontested Issues

1. Charitable Contributions

2. Membership Dues

3. Customer Deposits and Interest Expense

4. Outside Services Expense

5. Pension Expense

6. Automated Meter Reading

C. Contested Issues

1. Uncollectibles Expense

Ameren contends that Staff did not oppose the amount of uncollectibles expense presented in the test year. (Ameren IB, p. 33.) Staff's position is that a five-year average is a better indicator of the on-going level of expense than the one-year experience used by the Companies. (ICC Staff Exhibit 3.0, p. 13.)

Based on her experience, Ameren witness Karman believes that an increase in customers' bills will produce a corresponding increase in uncollectibles expense. (Ameren IB, p. 34.) However, based on the Companies' own historical information and confirmed by Ameren witness Opich during cross-examination (Tr., p. 296-297), this relationship has not existed for CIPS or UE during the past five years.

Ameren attempted to illustrate that Staff's five-year average methodology was flawed in that it did not consider upward or downward trends in the revenue and expense levels. (Ameren IB, p. 37.) However, as stated in Staff's Initial Brief at page 34, no such trends exist in the Companies' actual revenues or expense levels over the last five years. When expenses are of a volatile nature with no clear trends appearing over a period of time, using an average is the most appropriate methodology for determining a "normal" level.

Staff continues to dispute the Companies' attempt to establish a potential link between future gas costs and uncollectibles expense. Staff's discussion regarding why there is no link is discussed in detail in its Initial Brief, pages 33-36. However, Staff does disagree with one particular point made by the Companies. The Companies state that Staff did not counter their witness' contention that test year gas prices are far more consistent with the historical test year. (Id., p. 37.) However, what the Companies failed to note was this particular statement was made in Surrebuttal Testimony. Thus, Staff was not allowed to provide testimony to dispute that assertion. It is duplicitous for the Companies to make this claim given the circumstances surrounding the statement.

As noted in Staff's Initial Brief, pages 33-36, the record contains ample reason why the reliance on future gas costs to support the test year uncollectibles amount is improper and why Staff's methodology is preferred to the Companies' use of a test year value. Therefore, Staff's recommended value is superior to the Companies' requested amount and should be approved by the Commission.

2. VRP Cost Recovery

The Companies argue that there is no double recovery implicit in their proposal to include VRP costs in the revenue requirement. (Id., p. 42.) While they do not deny that the employees who took early retirement are still reflected in the FAS 87 test year service cost component, they state that the level of service cost in the test year pension expense is not adequate to cover the change in pension liability for the now retired employees. (Id.) The Companies did not provide Staff with information to verify this claim. Staff continues to recommend that the Commission adopt its adjustment to disallow the amortized VRP costs included in the Companies' revenue requirements, as discussed in Staff's Initial Brief, pages 36-38.

3. Amortization of VRP Costs

The Companies argue that the AG's adjustments to amortize VRP costs over a period of ten years do not provide a proper matching of costs and benefits since most of the employees accepting the VRP were near or at normal retirement age. (Id., pp. 42-

43.) This is inconsistent with Ameren witness Vogl's testimony that the liability portion of the FAS 87 pension expense calculation is much greater because employees accepting the VRP retired at a much younger age than was assumed. (Tr., p. 103.) At a three-year amortization level as proposed by the Companies, VRP costs would exceed VRP savings and ratepayers would receive no benefit from the VRP, from which the Companies expect to realize significant long-term savings. (Staff IB, p. 38.)

If the Commission decides that it is appropriate to allow recovery of VRP costs in the Companies' revenue requirements, Staff recommends the ten-year amortization period proposed by the AG over the three-year period proposed by the Companies. The ten-year amortization period is more reasonable because the benefits to the Companies derived from the early retirements, i.e., labor savings, will extend indefinitely into the future. (Id.)

4. Backfill of VRP Positions

Staff has agreed to allow recovery of labor expense for 60 employees who were hired to fill positions that became available due to the VRP. (Id., p. 40.) The Companies lament that it is unduly restrictive for Staff to disallow labor expense for 16 additional positions that the Companies expect to fill. (Ameren IB, pp. 43-44.) According to the Companies' logic, requisitions for the 16 positions have been approved, and an approved requisition is equivalent to a purchase order that has been issued. (Id.) The logic is faulty in that a requisition is actually a precursor to a purchase order. The approved requisitions only establish with reasonable certainty that the Companies want to fill the positions, not that the positions will be filled. It is unknown on what date people will be hired or on what date the Companies will begin to incur labor expense for the 16 positions. (Staff IB, p. 40.)

Staff's adjustments to labor expense for 16 unfilled VRP backfill positions that are not known and measurable are appropriate and should be adopted by the Commission.

5. Pension and Benefits Expense

Staff agrees with the AG regarding the introduction of updated 2003 budgets for pension and OPEB expense in the Surrebuttal Testimony of Ameren witness Vogl. The new budget figures are a last-minute and wholly improper attempt to introduce new evidence. (AG IB, p. 22.) They were presented under the guise of rebutting Staff's testimony regarding the double counting of pension and OPEB expenses in the VRP costs. (Staff IB, pp. 40-41.) Mr. Vogl maintains that there is no "double recognition" of the expenses. Therefore, the updated budget amounts were not offered to refute Staff's position regarding the VRP costs. (Id.) Also, the Companies did not update test year pension and OPEB expenses in a timely manner that allowed for discovery and verification. (Id., pp. 41-42.)

Staff recommends that the Commission reject the Companies' Surrebuttal Testimony adjustments to pension and OPEB expenses that are based on updated 2003 budget numbers, which are inappropriate, untimely, and unverified. (Id., p. 42.) Staff also recommends that the Commission accept the AG's adjustment to base test year pension and OPEB expenses on the 2002 actuarial study, since the Companies admit that the amounts based on the initial 2003 budgets are overstated. (Ameren IB, p. 45.)

6. Pension and Benefits, Capitalization Ratios

7. Wage Expense, 2003 Collective Bargaining Unit Increase

Formal negotiations between the Companies and the collective bargaining units have just recently begun. (Id.) Therefore, it is unknown when a new contract will take effect, if it will contain a pay increase, the rate of any increase, and the date the increase will become effective. (Staff IB, p. 43.)

It is not reasonable for ratepayers to pay for a pro forma wage increase that clearly does not meet the standard for a "known and measurable change" as required by 83 Ill. Adm. Code 285.150. Staff's adjustment is proper and should be accepted by the Commission.

8. Incentive Compensation Plan Expense

The Companies extol benefits ascribed to their incentive compensation plans (Ameren IB, pp. 46-50), as if Staff's adjustments to disallow incentive compensation expense were based on a lack of said benefits, while disagreeing with the concerns Staff has about assigning the responsibility for incentive compensation to ratepayers. (Id., pp. 50-53). Staff does not claim that the Companies' incentive compensation plans provide no benefits to ratepayers or even that the Companies are using incentive compensation to overpay their employees. (Tr., p. 449-451.) Staff proposes to disallow incentive compensation plan expense because the plans are dependent upon financial goals of the Companies that primarily benefit shareholders; ratepayers provide funding even if no costs are incurred by the Companies because plan goals are not met; the plans are discretionary and may be discontinued at any time; and prior Commission precedent supports the disallowance of incentive compensation. (Staff IB, p. 44.)

The Companies attempt to refute Staff's concern regarding the discretionary nature of the plans by making the ludicrous analogy that base wages for management employees could be discontinued at any time, so perhaps base wages should also be disallowed. (Ameren IB, p. 52.) The possibility that management would make such a decision is so remote as to be irrelevant to these proceedings. However, the possibility that management would decide to discontinue or suspend an incentive compensation plan is very relevant. In fact, management made such a decision when it decided to suspend the incentive compensation plan for contract employees for fiscal year 2003 (Staff IB, p. 46), thus underscoring the fact that the discretionary nature of the plans is not an idle concern.

In an effort to dispel Staff's concern regarding the fact that the incentive plans are dependent upon financial goals of the Companies that primarily benefit shareholders, the Companies mischaracterize Staff's answers to cross-examination questions concerning cost reductions. Staff did not "admit" that reductions in costs which increase earnings and benefit shareholders in the short run, also lead to lower rates, which benefit customers in the long run. (Ameren IB, p. 52.) While Staff agreed that controlling costs is one area that benefits both shareholders and customers (Tr., p. 453) and that, all other things being equal, earnings per share will increase if a company manages to decrease its costs (Id., p. 452), Staff also stated that it is likely that a utility is not going to need to come in for a rate case if it reduces its costs. (Id.) Increased earnings per share is a financial goal that primarily benefits shareholders; therefore, shareholders should bear the cost of paying incentive compensation. (Staff IB, p. 45.)

Staff's adjustments to disallow labor and the associated payroll tax expenses related to incentive compensation plans are just and reasonable and should be adopted by the Commission.

9. Advertising Expense

Expenses reflected in a revenue requirement should be representative of the level necessary on a going forward basis. Ameren agreed that the expenses included as advertising expense for the required Notice of Filing of the Gas Rate Increase for both CIPS and UE do not reflect an on-going level of expense. (AmerenCIPS/UE Exhibit No. 27.0, p. 11.) While Ameren suggests that the costs could be amortized as rate case expense (Ameren IB, p. 53), it did not reclassify those costs or indicate that its proposed rate case expense was less than adequate. Staff's adjustments to advertising expense should be approved as set forth on ICC Staff Exhibit 10.0, Schedules 10.4 CIPS and 10.4 UE.

10. Meter Reading Expense, Non-Labor

11. Income Tax Expense

Ameren, both in its Surrebuttal Testimony and Initial Brief, accepts Staff's methodology for calculating income tax expense. (AmerenCIPS/UE Exhibit No. 27.0, p. 13; Ameren IB, p. 56.) However, during cross examination, Ameren witness Opich stated that he did not believe that Staff's adjustments to income tax expense for CIPS and UE were appropriate. (Tr., p. 299.) Mr. Opich did not give any reasons at any time in the proceeding why he believed that Staff's adjustments were not appropriate. In its Initial Brief, Staff outlines why the proposed adjustments are necessary for the reflection of the correct amount of income tax expense in the revenue requirements for CIPS and UE. (Staff IB, pp. 48-49.) Staff's adjustments to income tax expense should therefore be approved for the reasons described.

12. Allocation of Rate Case Expense

The allocation method proposed by the AG is simply one way of dividing rate case expenses between CIPS and UE. (Staff IB, p. 50.) Given the fact that the costs incurred to prepare and file simultaneous rate cases for the affiliated interests in this consolidated proceeding are not materially affected by the size of each company, the Companies' method to allocate the current rate case expenses equally appears to be a fair sharing of the costs. (Id., p. 51.)

13. Amortization of Rate Case Expense

Staff and AG both propose to amortize the costs of this rate case over five years instead of three years as proposed by the Companies. (Staff IB, p. 51; AG IB, p. 26.) The Companies maintain that their expectation of requesting additional rate relief in three years is a more appropriate basis on which to establish an amortization period than the fact that it has been five years since the last rate case. (Ameren IB, pp. 56-57.) However, the Companies' past histories of filing rate cases show that there tend to be extended periods of time between rate relief filings. (Staff IB, p. 51; AG IB, p. 26.)

The Companies contend that a three-year amortization period poses no undue risk to customers because the Companies can "over collect" rate case expenses only if they are earning an excessive rate of return. (Ameren IB, p. 58.) Staff disagrees. If Ameren exceeds the selected amortization period before it initiates its next rate proceeding, it will over-recover rate case expense, and there is no mechanism for returning the over-recovered amount to ratepayers. (ICC Staff Exhibit 18.0, p. 8.)

The Commission should adopt the five-year amortization period for rate case expense proposed by Staff and the AG because it is more reasonable than the three-year amortization period proposed the Companies.

D. Recommended Operating Income/Revenue Requirement

IV. COST OF CAPITAL/RATE OF RETURN

Staff continues to differ with the Companies regarding AmerenUE's capital structure and costs of long-term debt and common equity as well as AmerenCIPS' costs of preferred stock and common equity.

A. Capital Structure

1. Uncontested Issues

a. AmerenCIPS' capital structure

b. AmerenUE's cost of preferred stock

2. AmerenUE, Common Equity Percentage

AmerenUE's capital structure proposal consists of 37.094% long-term debt, 2.594% preferred stock, and 60.312% common equity. (Ameren IB, pp. 24-25.) AmerenUE's proposed capital structure should be rejected in favor of Staff's recommended capital structure of 1.4% short-term debt, 43.6% long-term debt, 2.3% preferred stock, and 52.7% common equity. Staff's position was explained in Staff's Initial Brief. (Staff IB, pp. 54-58.) Staff will limit its response to statements in the Companies' Initial Brief regarding AmerenUE's capital structure that were not addressed in Staff's Initial Brief.

First, the Companies suggest that the Commission's approval of 57.04% and 58.08% equity ratios in two previous gas rate cases (Docket Nos. 95-0031 and 95-0219, hereafter referred to as "North Shore/NIGAS Rate Orders") somehow indicates that

AmerenUE's proposed 60.3% equity ratio is within a range of reasonable levels of common equity investment. (Ameren IB, pp. 62 and 64-65.) The Companies' argument is inadequately supported. The Companies have not shown the circumstances in those two cases to be the same as in the instant docket. For example, neither the North Shore/NIGAS Rate Orders nor the record in the current proceeding establishes (1) whether the Standard & Poors ("S&P") credit rating benchmarks were the same in 1995 as they are today or (2) the degree to which other factors, including the authorized costs of equity and the resulting pre-tax interest coverage ratios, influenced the Commission's decision to accept higher equity ratios in its North Shore/NIGAS Rate Orders than Staff recommends today. In contrast, Staff has demonstrated that its capital structure proposal in the instant docket produces a debt ratio that is squarely within, and an implied pre-tax interest coverage ratio that is well above, the guidelines for a company with a level of business risk similar to AmerenUE's gas operations to maintain an AA rating. In citing the North Shore/NIGAS Rate Orders, the Companies have merely established an upper bound of a range of equity ratios the Commission has allowed in past cases. That upper bound of 58.08% is still almost two percentage points lower than the 60.03% equity ratio proposed by AmerenUE, which further supports the conclusion that AmerenUE's proposed equity ratio is inappropriate for rate making purposes.

Second, the Companies criticize the Gas Sample capital structure data Staff witness McNally presented in Table 2 of his Rebuttal Testimony, claiming that the use of fiscal year-end short-term debt balances overstates the typical amount of short-term debt that combination gas/electric utilities such as AmerenUE utilize throughout the year. (Ameren IB, p. 64.) The Companies' criticism is unsupported and misleading. Mr. McNally used year-end capital structure data merely to demonstrate that the year-end data presented in Ameren witness McShane's Rebuttal Testimony overstates the Gas Sample's average equity ratio by excluding short-term debt and long-term debt due within one year. (Revised ICC Staff Exhibit 13.0, pp. 13-14.) Even if one were to suspend disbelief and accept the Companies' unsupported claim that the use of fiscal year-end short-term debt balances overstates the typical year-round debt usage to some degree, Ms. McShane's exclusion of short-term debt altogether clearly understates typical gas utility debt levels. Accordingly, when the appropriate amount of short-term debt and long-term debt due within one year are included (an amount undeniably greater than $0), AmerenUE's proposed 60.3% equity ratio exceeds the Gas Sample's average equity ratio by even more than the eight percentage points Ms. McShane's incorrectly calculated equity ratios indicate. Thus, Ms. McShane's comparison does not demonstrate that AmerenUE's proposed capital structure is reasonable for ratemaking purposes, but rather, indicates the opposite. In addition, the Companies' assertion that combination gas/electric utilities typically carry less short-term debt than pure gas distribution utilities is irrelevant, as this proceeding will set rates for AmerenUE's gas distribution operations only. Furthermore, that Value Line publishes capital structure ratios on the basis of long-term debt and common equity is not relevant. The Commission does not determine a utility's capital structure for rate setting purposes on the basis of the capital structure ratios published in Value Line. Moreover, the debt ratio benchmark that underlies Staff's capital structure adjustment is based on total capital, including short-term debt and long-term debt due within one year.

Finally, the Companies suggest that Staff should have only made the minimum adjustment necessary to place AmerenUE within a range of reasonableness. (Ameren IB, p. 65.) The Companies are wrong. The objective of Staff's capital structure adjustment was to establish a reasonable capital structure for a utility with a solid AA rating. (ICC Staff Exhibit 6.0, pp. 33-34; Tr., p. 618.) S&P provides a benchmark range for all AA ratings, from AA– to AA+. Thus, to establish a solid AA rating, an adjustment to approximately the midpoint of the S&P benchmark range is appropriate. Moreover, any capital structure adjustment smaller than that which Staff recommends would have necessitated a larger downward cost of equity adjustment.

3. Short-Term Debt Balance

The Companies object to the formula Staff used to calculate AmerenUE's short-term debt balance. (Ameren IB, pp. 65-67.) Although Staff's Initial Brief addresses most of the Companies' objections (Staff IB, pp. 59-60), the Commission should be mindful of two additional points. First, the Companies' arguments disregard the concern the Commission expressed with regard for the potential for double counting short-term debt arising from the Commission's rule for calculating the allowance for funds used during construction ("AFUDC"). (Order, Docket No. 95-0076, p. 51.) Staff's short-term debt adjustment directly addresses that concern by excluding that portion of short-term debt that the AFUDC formula assumes supports Construction-Work-in-Progress. Second, the Commission adopted Staff's formula for determining the balance of short-term debt in Section 285.4020 of 83 Ill. Adm. Code 285.

4. Recommended Capital Structure

B. Cost of Debt

1. Cost of Long-Term Debt

The Companies recommend the use of 12-month historical average interest rates for AmerenUE's long-term variable rate debt and AmerenCIPS' variable rate preferred stock, rather than the most recent interest rate observations, which Staff used. (Ameren IB, pp. 67-71.) The Companies' recommendation should be rejected. Given the inability to forecast the timing, direction, or magnitude of short-term interest rate changes, the most recent observation is the most accurate, naïve estimate of future short-term interest rates available; the use of historical average interest rates merely introduces a series of outdated interest rates. Staff's position was explained in Staff's Initial Brief. (Staff IB, pp. 60-64.) Staff will limit its response to statements in the Companies' Initial Brief regarding variable rate debt and preferred stock that were not addressed in Staff's Initial Brief.

First, the Companies object to the interest rates Staff recommends as being inconsistent with the test year. (Ameren IB, p. 67.) The Companies' objection is unfounded. As Staff explained, there is no requirement that interest rates be consistent with the test year, as cost of capital and its components are not test year items. (Order, Docket No. 99-0534, July 11, 2000, p. 22.)

Second, the Companies criticize Staff's claims that short-term interest rates approach a type of time series called a "random walk." (Ameren IB, p. 68.) Although the text that Staff cites does not explicitly state that interest rates simulate a random walk, it does state that the random walk theory applies to <u>securities</u> in general. Since debt is a type of security, it follows that the theory applies to interest rates as well. (Tr., pp. 605-607.) In addition, although certain studies indicate that securities are not completely random, which Staff does not dispute, Staff's assertion that short-term interest rates do not exhibit an exploitable repeating pattern stands uncontroverted.[2] Although inefficiencies in interest rates may exist, the Companies have provided no evidence that historical interest rates are predictive of future interest rates, as Ameren witness O'Bryan acknowledged.[3] (Id., p. 593.) Thus, given the inability to forecast the timing, direction, or magnitude of short-term interest rate changes, one cannot accurately say that historical interest rates are more representative of future interest rates than is the most recent spot rate. In fact, the Commission has concluded "it is clear that the cost of short-term debt and variable rate long-term debt should be measured using current interest rate instead of outdated historical averages…." (Order, Docket No. 99-0534, July 11, 2000, p. 22.)

Finally, the Companies note that Staff witness McNally acknowledged that he believes interest rates are more likely to rise than fall. (Ameren IB, p. 69.) However, Mr. McNally also noted that he does not know when that may occur. (Tr., p. 610.) Moreover, since Staff's analysis, interest rates have fallen. (Id., p. 593.) As noted in Staff's Initial Brief, until interest rates rise above the level the Commission adopts in this proceeding, the Companies will continue to benefit from low interest rates. The

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[2] Regression to some mean value, which the use of historical average interest rates implies, is a type of repeating pattern, which investors could exploit. That is, if the current interest rate on a debt security were below the mean to which that interest rate is going to return, investors would not purchase that debt security.

[3] The Companies distinguish between the "representativeness" and predictive accuracy of historical average interest rates. (Ameren IB, p. 68.) This is a distinction without a difference. Logically, for any interest rate, historical average or otherwise, to be "representative" of the interest rate that will prevail in the future, it must accurately predict that future interest rate. An interest rate that is an inaccurate predictor of future rates is only "representative" of the wrong interest rate.

Companies are seeking to charge rates in excess of their current costs on the speculation that their costs will rise – eventually. The Commission should not base rates on speculation. (Staff IB, p. 63.)

2. Cost of Short-Term Debt

C. Cost of Preferred Stock

See Cost of Long-Term Debt section, IV.B.1, discussed *supra*.

D. Cost of Common Equity

1. Companies' Recommendations

a. DCF analysis

b. Risk premium analysis

c. CAPM

d. Achieved risk premium

e. Forward-looking risk premium

f. Risk premium analysis conclusion

g. Comparable earnings analysis

h. Recommendation

2. Staff's Recommendations

a. DCF analysis

b. Risk premium analysis

c. Recommendation

3. Contested Issues

a. Beta estimates

The Companies criticize the regression beta estimate used in Staff witness McNally's CAPM analysis. The Companies claim that Staff's regression betas are not as representative of the typical risk relationship between natural gas distribution companies and the overall equity market as are Value Line and Bloomberg betas. (Ameren IB, pp. 91-92.) The Companies' argument, which is speculative and flawed, was fully debunked in Staff's Initial Brief. (Staff IB, pp. 74-76.)

b. Risk-free rate

The Companies argue that Staff's 5.24% risk-free rate estimate is unsustainably low and notes that forecasts presented by Staff indicate a risk-free rate of approximately 6.0%. (Ameren IB, pp. 92-93.) Again, the Companies' argument is speculative and should be rejected. Staff's position was fully explained in Staff's Initial Brief. (Staff IB, pp. 76-77.)

c. Market to book adjustment

The Companies recommend that market-to-book adjustments be made to all market derived cost of equity estimates, claiming that James Tobin's "Q-ratio" theory supports such an adjustment. (Ameren IB, pp. 94-98.) The Companies' proposed market-to-book value adjustment is based on the flawed argument that a market-derived required rate of return does not produce a "fair" return when applied to a book value rate base if the market-to-book value ratio differs from one. That argument has been rejected by the Commission in numerous prior proceedings and should be rejected once again. Staff's position, including a refutation of the Companies' Q-ratio rationale, was explained in Staff's Initial Brief. (Staff IB, pp. 77-80.)

The Companies cite the landmark Hope and Bluefield court cases in an attempt to support their market-to-book adjustments.[4] (Ameren IB, pp. 72, 75, 95, and 96.) However, those decisions do not support the Companies' conclusions. In the more recent Hope ruling, the Court stated:

> Rates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid, even though they might produce only a meager return on the so-called "fair value" rate base. (320 U.S. 591, 605 (1944).)

The Companies have not presented any evidence that they have been unable to operate successfully, maintain their financial integrity, attract capital, and compensate their investors for the risks assumed. In fact, the record supports the opposite. Although the Commission has rejected the very type of market-to-book adjustment that the Companies espouse both explicitly (See Amended Order, Docket No. 97-0351, June 17, 1998, p. 42) and implicitly through its practice of setting a utility's authorized rate of return on common equity to the investor-required rate of return (See Order, Docket No. 99-0121, August 25, 1999, p. 68), both AmerenCIPS and AmerenUE have managed to maintain A– credit ratings, while the latter's financial strength is commensurate with a very strong AA rating.[5] (ICC Staff Exhibit 6.0, pp. 10-12.) Further, since March 2000, the Companies have issued $744.6 million in debt at competitive interest rates. (ICC Staff Exhibit 6.0, Schedule 6.4 CIPS; Revised ICC Staff

[4] Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 79 (1923) and Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 391 (1944).
[5] AmerenUE's affiliation with non-utility and unregulated entities has adversely affected its credit rating. (ICC Staff Exhibit 6.0, pp. 9-10.)

Exhibit 13.0, Schedule 13.4 UE.) Thus, the empirical evidence clearly shows that the Companies' market-to-book adjustment is neither required as a matter of law nor necessary as a matter of finance.

d. Comparable earnings analysis

E. Recommended Overall Rate of Return on Rate Base

Staff has clearly demonstrated that the appropriate overall costs of capital for AmerenCIPS and AmerenUE equal 8.29% and 8.19%, respectively. Moreover, Staff has shown that the Companies' methodologies are flawed, their criticisms of Staff methodologies are without merit, and the arguments of their witnesses are generally not credible. Based on the evidence and arguments presented by Staff and the weakness of the Companies' positions, Staff recommends that the Commission adopt Staff's overall cost of capital proposals.

V. COST OF SERVICE STUDY

A. Introduction

B. Uncontested Issues

1. Allocation of Propane Costs, Storage Costs and the Carrying Cost of Working Gas in Storage between Sales and Transportation Customers

This issue is not contested. The arguments in Staff's Initial Brief stand on their own.

C. Contested Issues

1. Allocation of Transmission Plant

The Companies' Initial Brief fails to provide any meaningful basis for allocating transmission plant according to non-coincident peak demands. The argument on behalf of the allocator is limited to the following:

> Mr. Difani explained that rate design experts have utilized both CP [coincident peak] and NCP [non-coincident peak] allocation methods, and leave the decision as to which is more appropriate up to the individual circumstances. Mr. Difani explained that the use of the CP produces an inequitable allocation of costs to the Company's other classes because interruptible customers are not included in the calculation of class peak demands. On the other hand, the use of the NCP will appropriately allocate costs to all classes including the large-use interruptible customers as their demands are included in the calculation of class peak demands. [cite omitted]Accordingly, the use of the NCP should be approved. (Ameren IB, pp. 99-100.)

This discussion reveals that the Companies are relying on a single argument for the non-coincident peak approach. The argument maintains that the use of non-coincident demands is more equitable because it allocates transmission costs to all customer classes, including interruptible customers.

The problem with this argument has been fully explained by Staff. The Companies make a fundamental error in using equity considerations as a basis for allocating system costs. Allocations should instead be strictly based on cost causation principles.

The use of non-coincident peak demands is inconsistent with a cost-based approach. As Ameren has admitted in the hearing process, transmission plant investments are driven by coincident peak demands. (Tr., pp. 171-172.) Thus, an allocation based on non-coincident peak demands clearly deviates from cost causation principles and should be rejected by the Commission.

A more reasonable approach is to allocate transmission plant by the Staff-proposed Average and Peak ("A&P") method. This approach not only reflects costs in a more appropriate manner but it also follows Commission precedent, having been accepted for ratemaking in the Companies' most recent rate cases.

2. Allocation of Distribution Plant

Ameren's efforts to defend its proposed Average and Excess ("A&E") allocator in its Initial Brief deserve to be rejected. The Commission should instead reaffirm the use of the A&P allocator proposed by Staff in this case.

The Companies begin their discussion with a ludicrous argument concerning citations to allocation methodologies in NARUC cost-of-service manuals. As the Companies point out, the A&E was mentioned in the 1981 NARUC manual. (Ameren IB, p. 100.) Staff and CUB, in turn, noted that the A&P allocator is discussed in the 1989 Manual. (Id.) Nevertheless, Ameren insists that the 1981 manual carries more weight because "nothing in the 1989 guide suggests that it supersedes, or was intended to supersede, the 1981 publication". (Id.) Ameren is looking for distinctions that do not exist. The fact remains that the manuals discuss both allocators and therefore provide no basis for concluding that NARUC prefers the A&E over the A&P.

Ameren also registers a complaint about the A&P, arguing that it excludes interruptible customers from the demand component of the allocator and therefore unjustly shifts costs from interruptible to firm customers. (Id., pp 100-101.) The complaint is unjustified on two counts. First, as Staff has demonstrated, the relevant demands driving distribution investments occur at the time of system peak. If customers are designed to be interrupted at the system peak, then their demands do not shape these costs. Second, Staff has argued in this proceeding for eliminating interruptible service on the Ameren systems. If this reasonable proposal is accepted, then the issue of proper cost allocations for interruptible customers disappears.

Ameren then presents a thoroughly confused argument concerning the issue of double counting demands in the allocation of distribution plant. Ameren creates confusion right from the start with the following statement:

> Additionally, Mr. Lazare also argued that the A&E methodology "double counted" average demands. (Id., p. 101.)

In fact, the double counting argument was presented not by Mr. Lazare but by Ameren witness Difani to criticize Staff's A&P allocator. He states as follows in testimony:

> Thus, under the A&P methodology, the average demand (A) is allocated twice, first on its own and then as a component of the peak (P). AmerenCIPS/UE Exhibit No. 33.0, p. 5.)

Ameren also restates Mr. Difani's surrebuttal arguments, which use diagrams in an effort to demonstrate that Staff's proposed A&P allocator double counts average demands. The diagrams show a cross-section of a main, which is divided between an average and an excess component. Ameren notes that the A&E has one allocator for the average component and another allocator for the excess component while the A&P includes average demands not only to allocate the average component but also in the peak demand allocator for the excess component. Ameren concludes that because the A&P includes average demands in both the average and excess areas while the A&E does not, the A&E is more reasonable. (Ameren IB, pp. 101-102.)

The Companies' argument is flawed in two key respects. First, it does not demonstrate the reasonableness of the A&E approach. The A&E allocates the excess component of the main according to non-coincident peak demands. So, if one class peaks in October, the A&E uses those October demands to allocate the excess that occurs during the winter peak. The relevance of these October demands for allocating the excess component of distribution mains has not been illustrated by the Companies. (ICC Staff Exhibit 7.0, pp. 6-7.)

Second, the Companies' diagrams represent only a snapshot of the distribution system during the time of system peak. What they fail to show are the economic factors that drive distribution costs. As Staff has explained, there must be sufficient demand throughout the year to justify the construction of the distribution system. That is why the A&P reflects average demands in addition to peak demands. (Id.)

3. Allocation of Account 383

The Companies' argument for these costs narrowly focuses on the claim that the proposed allocation reflects more specific information than Staff's proposal for these costs. Ameren IB, p. 103.) This discussion conveniently omits the fundamental deficiencies in Ameren's proposal. First, the Companies have chosen to deviate from the methodology adopted by the Commission in their most recent rate cases without offering any explanation why. Furthermore, the filings conspicuously lack any explanation or even mention of this proposal. Finally, Ameren's Initial Brief alludes to "detailed regulator specific data" and yet Ameren has failed to provide any meaningful breakdown of this data. (Id.)

These deficiencies demonstrate that the Companies have failed to meet the minimum requirement for the Commission to reconsider their current allocation methodology based on meters which is the approach proposed by Staff in this proceeding.

4. Allocation of Account 386

The Companies support their proposed allocator for this account by seeking to draw a contrast with Staff's proposal. While claiming that Staff's proposal is based "simply" on meter costs which have "no tie to the investment in this account," Ameren contends that its approach is based on "more specific Company records" at least for the residential class. (Id.) Ameren's Initial Brief does not explain how the allocation to non-residential customers according to previously allocated distribution plant improves on Staff's proposal.

Ameren's proposal for Account 386 creates similar problems to its proposal for Account 383. Again, the Companies have chosen to deviate from the Commission-approved allocator for these costs without providing any meaningful explanation why. (AmerenCIPS/UE Exhibit No. 20.0, p. 2.). Furthermore, the Companies fail to identify what actual cost data is used for the residential component of its proposed allocator. (ICC Staff Exhibit 14.0, p. 8.) Finally, the Companies have not explained why combining actual cost data for residential customers with a distribution plant allocator for others is reasonable.

In contrast, Staff proposes a reasonable allocation based on meters for all customers, which is consistent with Commission precedent and should be adopted by the Commission in this case.

5. Allocation of Account 879

Ameren's defense of its proposed allocator for this account which consists of equipment installed on customers' premises boils down to the following sentence:

> Because these activities are performed for all customer classes and go well beyond the “service line”, the Company’s allocation based on previously allocated distribution plant more equitably reflects the costs associated with the full range of expenses in this account than does the Staff’s “service line” allocator. (Ameren IB, p. 104.)

The problems with the Companies’ proposal have been fully exposed in this proceeding. The Companies have chosen to deviate from Commission precedent with an allocation based on belated and incomplete support. Specifically, Ameren witness Difani fails to explain why Account 879 Customer Installation Expenses, which includes activities such as “leak testing, re-lighting pilot lights, activating and disconnecting meters”, is more related to previously allocated distribution plant than service lines as determined by the Commission in the Companies previous rate case. Thus, Ameren provides an insufficient basis for deviating from Commission precedent on this issue. The Commission should, instead, reaffirm that precedent by adopting the Staff-proposed approach.

6. Allocation of Account 902

It is difficult to respond to Ameren’s arguments concerning the allocation of Account 902, Meter Reading Expenses, because Ameren bases its discussion on a misunderstanding of the allocator Staff proposes for these costs. Regarding Staff’s proposed allocator for this account, Ameren’s Initial Brief states:

> The Staff’s use of a meter allocator assumes that meter-reading expenses for AmerenCIPS are directly related to the cost of the meter.” (Id., p. 104.)

This statement stands in direct contradiction with the following statement by Ameren witness Difani in his Surrebuttal Testimony:

> I would like to correct my rebuttal testimony and note that Staff has allocated meter reading costs based on the number of meters, not the cost of meters… (AmerenCIPS/UE Exhibit No. 33.0, p. 6.)

This statement is revealing in two respects: first, it correctly notes that Staff's proposed allocator for Account 902 is, in fact, based on the number of meters, not on the cost of meters as stated in Ameren's Initial Brief; second, it reveals that Ameren has reverted to a misunderstanding regarding Staff's allocator.

It is difficult to respond to this confusion beyond stating that the Staff approach based on the number of meters conforms to Commission precedent and should be adopted in this case.

7. Allocation of Account 912-916

The Companies' argument for these accounts is limited to a claim that Staff's revenue-based allocator for these costs "results in gas transportation customers evading a large portion of these expenses." (Ameren IB, p. 105.) This statement, unaccompanied by any tangible support, does not justify a deviation from the current Commission-approved allocation of these costs and should be ignored. (ICC Staff Exhibit 14.0, p. 8.)

8. Allocation of Storage Costs Between Sales and Transportation Customers

See discussion on this issue at Section V.B.1 *supra*.

9. Allocation of Revenue Requirement

The Companies argue that the revenue requirement should be allocated by rerunning the cost of service study consistent with whatever changes the Commission orders, rather than allocating any reduction from the Companies' original proposal first to the Residential and General classes as CUB proposes. (Id., p. 107.) Staff agrees with Ameren on this issue.

VI. RATE DESIGN; TARIFF TERMS AND CONDITIONS

A. Introduction

B. Uncontested Issues

1. Transportation Specific Administrative Charges

C. Contested Issues

1. Residential Customer Charge

The Companies and CUB continue to disagree about the appropriate method of calculating customer charges. The Companies advocate an embedded cost approach while CUB favors an avoided cost calculation. (Ameren IB, p. 109.) Staff has focused in this case on embedded costs and customer impacts and found the Companies' methods reasonable on both counts. (ICC Staff Exhibit 7.0, p. 16.) Nevertheless, Staff reserves the right to revisit the customer charge issue in future cases to explore other costing approaches.

2. Residential Usage Charge, Flat vs. Declining Block

Ameren's Initial Brief fails to provide persuasive arguments on behalf of its proposed declining block rate. Instead, the Companies recycle flawed arguments that have been thoroughly discredited during the course of this proceeding.

The Companies begin their discussion by criticizing Staff's proposal to adopt a flat rate. The Companies maintain that the flat rate proposal is intended to reduce consumption and should therefore be accompanied by an adjustment to billing determinants. Ameren then concludes that Staff's failure to propose such an adjustment creates the potential for AmerenCIPS and AmerenUE to under-earn. (Ameren IB, p. 110.)

This argument has been fully refuted by Staff, who notes that the same concern can be expressed about the Companies' significant rate increase which produces a virtually identical impact on the tailblock rate as Staff's flat rate proposal. The analysis indicates that replacing the current declining block rate for AmerenCIPS with a flat rate raises the tailblock rate from the existing 11.64 cents per therm to 14.33 cents per therm. In comparison, Ameren's proposed rate increase includes a tailblock rate of 14.26 cents per therm for these customers. For AmerenUE, the proposed increase has a greater impact on the tailblock rate than Staff's flat rate proposal, raising it to 19.42 cents per therm, compared with an increase to 17.55 cents per therm due to the adoption of a flat rate. Ameren's proposal could have an even greater effect on consumption because it also increases the customer charge and the first block usage charge for Residential customers. (ICC Staff Exhibit 14.0, pp. 15-16).

The preceding discussion clearly demonstrates that Ameren's own proposals have a far greater impact on rate levels than Staff's flat rate proposal. Yet, while the Companies demand that billing determinants be adjusted to compensate for Staff's proposal, they do not seek a similar adjustment for their own proposals. (Id., p. 16.) Thus, the Companies' argument is arbitrary and inconsistent and should be rejected by the Commission.

Ameren then takes up the issue of fixed costs, and seeks to explain how the existence of these costs lends support to a declining block rate structure. According to the Companies, fixed charges are incurred independently of the level of consumption on the system. Thus, if Staff's flat rate proposal is accepted, the Companies argue it would be subject to the vagaries of the weather for fixed cost recovery. (Ameren IB, pp. 110-111.)

The Companies' argument is burdened by a basic misunderstanding of fixed costs. For example, Ameren states the following concerning the nature of fixed costs:

> Fixed costs are those that apply regardless of the amount of a customer's consumption; volumetric charges are charges that apply to each unit consumed. While it would appear that the recovery of fixed costs through fixed charges and variable costs through volumetric charges would be a sensible way of recovering utility cost of service, there is a great deal of customer resistance to such a structure. (Id., p. 110.)

The problems with this argument have been well-documented by Staff. Most importantly, Staff has shown that the argument fails to account for the differences between fixed costs on the Ameren system. While some fixed costs are clearly customer-related and appropriately recovered through monthly customer charges, other fixed costs are shaped by customer's demands and appropriately recovered in variable charges. For customers with usage meters that means recovery through delivery charges. (ICC Staff Exhibit 14.0, p. 12.)

Ameren then returns to the under-earning issue raised earlier in its Initial Brief, arguing that Staff's proposed flat rate by encouraging conservation will prevent it from recovering its fixed costs. (Ameren IB, p. 112.) With this statement, the Companies again seek to blame any possible revenue shortfalls on Staff's flat rate proposal. However, this argument fails to take into account the fact that the Companies' own proposals put greater upward pressure on rates than Staff's proposed flat rate. Furthermore, Ameren's arguments fail to take into account the fact that these fixed costs are appropriately recovered through variable charges and may be under- or over-recovered. That is the nature of utility ratemaking. Nothing is guaranteed.

Ameren concludes its argument by claiming that the declining block rate proposal does, in fact, encourage customers to conserve. The Companies state that a tailblock set to zero would expose the declining block to criticism from a conservation standpoint. But Ameren stresses that is not the case. Ameren adds the point that residential customers are also subject to the PGA which is applied on a flat rate basis. (Id., pp. 112-113.)

Ameren's argument fails to address the central problem with the declining block rate proposal from a conservation standpoint; as consumers move into the higher block, the per-therm price declines. This lower tailblock rate gives ratepayers an incentive to increase their gas consumption, rather than conserve, which is an inappropriate price signal to send to consumers. (ICC Staff Exhibit 7.0, p. 17.) Furthermore, the discussion of the PGA is irrelevant because its structure will be unaffected by the outcome of this proceeding.

Finally, it should be noted that CUB lends its support to flat rates. (CUB IB, pp. 10-11.)

3. Size of Residential First Block

4. Grain Dryer Rate

5. Elimination of Interruptible Service

Ameren presents two separate arguments in its Initial Brief against eliminating interruptible service on the AmerenCIPS and AmerenUE systems. It supports interruptible service for AmerenCIPS to address localized constraints on the distribution system. (Ameren IB, p. 116.) Ameren argues that interruptible service is necessary for AmerenUE customers to avoid adverse bill impacts. (Id., p. 117.)

For AmerenCIPS, Ameren continues to assert that interruptible service is necessitated by system constraints, even though customers have not been interrupted for at least five years. (Id., p. 116.) Ameren goes on to complain that the elimination of interruptible service would leave it with the unhappy choice of curtailing load or expanding the system. (Id., pp. 116-117.) However, the statement is undermined by the fact that Ameren has failed to curtail any customers since 1997. During this time, Illinois has experienced some extreme weather, including the third coldest December since 1895 according to the National Oceanic and Atmospheric Administration. (ICC Staff Exhibit 7.0, p. 11.) Nevertheless, AmerenCIPS has managed to serve the demands of all customers, firm and interruptible, during this time. Thus, there is every reason to believe that AmerenCIPS should be able to serve all demands into the foreseeable future. (Id., pp. 10-11.) This undermines the argument against eliminating interruptible service on the AmerenCIPS system.

With regard to AmerenUE, the Companies' Initial Brief indicates that the only reason for maintaining interruptible service is to avoid the rate impact that would result from its elimination. (Ameren IB, p. 117.) As Staff has pointed out, this is a poor excuse for continuing interruptible service. If the cost of serving these customers is no different from the cost for firm customers then fairness dictates that the rates be the same. Otherwise, Ameren would be unfairly discriminating in favor of interruptible customers over firm customers. (ICC Staff Exhibit 14.0, p. 10.)

6. Reduce Restrictions on Access to Interruptible Service

7. Elimination of Minimum Monthly Charges

8. Group Balancing Service

The proposal to hold workshops and implement a group balancing service is, for all intents and purposes, an uncontested issue. The Companies argue that group balancing services should be implemented on a pilot basis. (Ameren IB, p. 119.) Staff respectfully requests that the Commission refrain from ordering the Companies to implement any specific terms or conditions related to group balancing service, including the pilot status issue, in the instant proceeding. (ICC Staff Exhibit 12.0, p. 12.) The workshop process can be used to deliberate the merits and necessity of a pilot program approach as well as other terms and conditions of the group balancing service. If, after the workshops, the Companies feel that a pilot program approach, such as the one they advocate in the instant proceeding, is necessary, they can propose such an approach when they file group balancing tariffs. The Commission can then decide how to resolve any concerns over the specifics of group balancing tariffs filed by Ameren with the knowledge that such issues were addressed in greater detail through the workshop process.

Ameren also argues that the Commission should only require the Companies to hold workshops but not specify the number of workshops to be held. (Ameren IB, p. 120.) Staff argues that the Companies should be required to hold at least three workshops and would not object to holding the workshops between the period of November 2003 and March 2004. Staff would not be opposed to less than three workshops if, during the workshop process, the parties agree that process can be concluded in less than three workshops. (ICC Staff Exhibit 12.0, p. 12; Staff IB, p. 108.)

9. Bank Balance Withdrawal Limit

BEAR, MEC and Staff initially took issue with delivery requirements and restrictions on Bank withdrawals in the Companies' transportation tariffs. MEC argued that the Companies' delivery requirements are too strict and make it difficult, if not impossible, to meet the varying demands of transportation customers. (MEC IB, p. 5.) MEC argues that placing such stringent requirements on transportation customers has resulted in a reduction in the number of marketers and transportation customers and jeopardizes retail natural gas competition in the Companies' service territories. (Id.) MEC and BEAR recommended that the restrictions on bank use only apply on critical days. (MEC Exhibit A, p. 7; BEAR Exhibit 1.0, p. 12.)

Staff witness Iannello initially echoed MEC's and BEAR's concerns and still has reservations regarding the Companies' delivery requirements and Bank withdrawal limits. (ICC Staff Exhibit 6.0, pp. 16-19.) The Companies, in response to Staff and intervenor concerns over transportation customer access to storage, proposed to reallocate a portion of storage plant and related expenses to reflect the relatively limited access to storage that transportation customers are afforded. In addition, the Companies agreed to implement group balancing services and review current terms for balancing and limitations on Bank withdrawals. (Ameren IB, p. 119.) In light of these proposals, Staff witness Iannello agreed to withdraw his proposed revisions to the Companies' delivery requirements and Bank withdrawal limitations. However, he stated, "I continue to be concerned that the Compan[ies]' proposed limitations on deliveries and Bank withdrawals discriminate against customers with loads that fluctuate unpredictably on a day-to-day basis…" (ICC Staff Exhibit 12.0, pp. 11-12.) Mr. Iannello views the Companies' proposal to reallocate some of the storage plant and related expenses as a reasonable compromise until terms and conditions of group balancing service can be devised that relieve the burdensome delivery requirements currently placed on transportation customers. (Id.)

10. Cash-out Mechanism for Transportation Customers

BEAR witness Smith took issue with the Companies' cash-out mechanisms. She stated, "[i]f the customer has not utilized his/her bank gas, there is no opportunity to "cash out" his/her bank balance at the end of a month or at any time." (BEAR Exhibit 1.0, p. 11.) She argued that transportation customers should have the ability to cash out their bank balance at the end of the month even if they did not use their banked gas. (Id.) While such an option is not unreasonable, Ms. Smith did not recommend any specific tariff provisions that would allow her proposed cash-out mechanism to be implemented. Staff believes that Ms. Smith's concerns would be best addressed through the group balancing workshop process proposed by Staff and adopted by the Companies and MEC.

11. 15-Day Requirement for New Services

Staff disagrees with the reasons provided by the Companies in their attempt to avoid revising their tariff language to require them to install new services in 15 working days or less except under certain extenuating circumstances not under the control of the Companies. In particular, the Companies noted there is no evidentiary foundation on which the Commission could order the recommended change in the Companies' tariff. (Ameren IB, p. 125.) Staff disagrees. Staff's Initial Brief, pages 111-116, details the reasons why the proposed tariff language should be added to the Companies' tariffs. These reason do not require repeating here.

However, the Companies do raise several additional points that Staff does address below. In particular, the Companies claim that Staff failed to provide any analysis of the cost of instituting the proposed tariff language, the proposed tariff language is unclear, and the proposed tariff language bears no relationship to the Companies' operational reality. (Id., pp. 126-127.)

Regarding the allegation that Staff failed to provide any cost analysis regarding the proposal, Staff admits that this is an accurate statement. However, the reason for the lack of any analysis falls squarely upon the Companies. The Companies were unable to provide an estimate regarding the percentage of customers requesting new service installations that received service within 15 working days. (AmerenCIPS/UE Exhibit No. 24.2.) Further, the Companies' waited until Surrebuttal Testimony to opine that additional labor expense would be incurred if the Companies had to add employees in order to meet the 15 working day deadline and there would be programming costs incurred to identify, track, and report new service installation requests. (AmerenCIPS/UE Exhibit No. 24.0, p. 5.)

However, the Companies were unable to state that any additional employees would be needed to comply with Staff's proposed language or that their current workforce in insufficient to meet the tariff requirements. Without those details, the Companies' statement is pure speculation. Further, the Companies did not provide any estimates for these "programming" costs nor did they state the Companies would have to hire additional computer programmers or administrators to comply with this requirement. Therefore, given the apparent lack of concern the Companies had regarding quantifying these costs, Staff concludes any additional costs the Companies would incur are minimal.

The Companies' claim that the proposed language is unclear comes as quite a surprise to Staff. The Companies had ample opportunity to raise any concerns they had regarding the specific language of Staff's proposed additions to their tariffs. However, the Companies failed to offer any alternative language to Staff's proposal. (Tr., p. 569.) Nevertheless, the Companies now claim the proposed rule is unclear about what would or would not be included in the list of "calamities" that would allow the Companies to exceed the required 15-working day deadline. (Ameren IB, p. 126.) However, Staff previously explained to the Companies that it could not tell them how to protect themselves should they exceed the 15-working day time limit, but that the tariff language provides the basis for a utility to exceed the 15-working day deadline. (Tr., pp. 559-561.) Further, the Companies attempt to hold Staff's proposed tariff language to the standard that every conceivable circumstance is discussed in detail is unreasonable and unwarranted. The Companies' comments should be recognized for what they are, a last minute attempt to cloud the issue and to divert attention away from the Companies' lack of desire to institute the proposed tariff language.

The Companies' final statement was that the proposed language bears no relationship to the Companies' operation realities. However, as noted above, the Companies were unable, or unwilling, to provide similar information to Staff regarding their operations. The Companies could not tell Staff the percentage of customers that receive new service installations within 15 working days nor did the Companies quantify any alleged costs that would be incurred should the proposed language receive approval. Further, the record is silent regarding how the proposed language could somehow violate the Companies' operations.

Staff's proposal to add tariff language that would require the Companies to install new service requests within 15 working days under certain circumstances is in the best interests of the Companies' customers. Staff's proposal addressed all of the various concerns raised by the Companies about the proposed tariff language and is a proactive step in assuring the Companies' customers do not see any deterioration in their service quality. Therefore, the Commission should require the Companies to add Staff's recommended tariff language to their tariffs.

VII. CONCLUSION

For the reasons set forth in its Initial Brief and this Reply Brief, Staff respectfully requests that the Commission's Order reflect Staff's modifications to the Companies' proposed general increase in natural gas rates.

Respectfully submitted,

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